

22nd Century Group, Inc. (XXII - \$1.40 - Buy)

Estimate Change

COMPANY NOTE

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Sales and trading 7 a.m. to 7 p.m. ET, (646) 465-9090

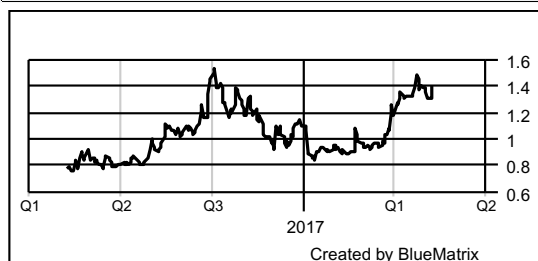
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Stock Data		05/09/17
Price		\$1.40
52 Week Range		(\$0.74 - \$1.71)
Price Target		\$3.50
Market Cap (mil)		\$126.98
Shares out (mil)		90.70
3-Mo Avg Vol		948,295
Cash per share		\$0.12
Total Debt (mil)		\$0.31

Revenues (\$ millions)						
Yr Dec	2016A		2017E		2018E	
	Actual	Curr	Prev	Curr	Prev	
Mar	3.0	2.2	1.6	–	–	
Jun	2.8	2.6	–	–	–	
Sep	3.1	6.0	–	–	–	
Dec	3.3	6.6	–	–	–	
YEAR	12.3	16.5	15.9	21.5	–	

EPS (\$)						
Yr Dec	2016A		2017E		2018E	
	Actual	Curr	Prev	Curr	Prev	
Mar	(0.04)	(0.03)A	–	–	–	
Jun	(0.04)	(0.03)	–	–	–	
Sep	(0.03)	(0.02)	–	–	–	
Dec	(0.03)	(0.02)	–	–	–	
YEAR	(0.15)	(0.10)	–	(0.10)	(0.09)	

One year price history XXII



Q1 Beat and Raise. Multiple Catalysts Pending

We reiterate our Buy recommendation and \$3.50 price target on 22nd Century post the company's Q1 results, increased guidance to this year and indications of a strong and event-filled 2018. Q1 revenue of \$2.2 million exceeded our \$1.6 million estimate while opex was a bit more than modeled. On the back of new manufacturing agreements for the production of filtered cigars and other tobacco products, the company is now guiding to \$16 million in total revenue in 2017 and significantly more than \$20 million in revenue in 2018. Both are above our estimates. In addition the coming months and quarters are laden with catalysts as 22nd Century pursues multiple paths to address the smoking-cessation market as well as introducing unique products to the smoking market which is 10x larger than the smoking cessation market.

In June the company meets with the FDA's CEDR (Center for Drug Evaluation and Research) for a pre-Phase III Meeting on X-22. X-22 is contemplated as a prescription-only product for the smoking cessation market. There have been many trials using X-22 as a smoking cessation tool, all with positive results, and the company will determine, with the FDA, the best path forward. One path would be a Phase III trial in 2018.

Also in June, 22nd Century meets with the FDA's Center for Tobacco Products for a guidance meeting to determine the way forward on a reduced exposure designation for its Brand A, very-low nicotine cigarette. The current thinking is bifurcating the application into a Premarket Tobacco Product application) and MRTPA (Modified Risk Tobacco Product application). The PMTA could advance quickly while the MRTPA would likely take 12 months to conclude.

Recently, the company announced it will pursue an MRTPA for Brand B, the company's low tar-to-nicotine product. This is a third path for commercialization in a market that has been prevented by government from innovating. However, because of the company's unique technology as well as progress on determining, in conjunction with the FDA, the efficacy of 22nd Century's products on smoking cessation and smoking behavior, it could end up offering a truly innovate product to the market.

Contract manufacturing does not generate positive margins, yet, but will with scale. Because of the recently announced manufacturing agreement, 22nd Century expects to generate \$16 million in sales this year and significantly over \$20 million next year. Even so, this will be a low-margin business, but will contribute to covering corporate overhead as revenues scale.

At the end of the quarter the company had \$10.7 million in cash, enough, we believe, until the middle of next year and maybe longer at current operational needs.

Over the coming months we expect news on FDA guidance on X-22

the PMT and MRTP applications for Brand A, progress on Brand B and continuing news on the industrial hemp market. The key for the shares remains monetization of the company's technology to control nicotine levels in tobacco. This can be used for smoking cessation products and 22nd Century is pursuing multiple paths here including applications with the FDA for a reduced exposure designation. We also believe the technology is suitable for heat-not-burn products that industry leaders like Philip Morris International are pursuing.

We value X-22/Modified risk at \$2.50 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.00 per share to reflect a modest tempo in the roll-out of commercial products as well as a less steep ramp for the BAT royalties. We have not given any value for the company's 25% ownership of Anandia or its exclusive US rights to four genes required for cannabinoid production in the cannabis plant. Risks to achieving our price target include delays in the FDA process, ability to find partners for X-22, challenges in attracting contract manufacturing and selling product overseas and possibility of requiring additional capital.

Investment Summary:

The company's path to value creation remains the same: monetizing its extensive intellectual property which allows it to modulate the level of nicotine in tobacco plants through genetic engineering and plant breeding. There are a number of paths the company is pursuing to monetize this technology.

One of the most promising paths for 22nd Century is the pending application with the FDA for a reduced exposure designation for its Brand A, low-nicotine cigarette.

Most of the company's revenues this year have been for contract manufacturing which it is seeking to expand.

Recently, in testimony for the Crede litigation, the company stated that its patents are worth more than \$200 million, or greater than \$2.50 per share. We value X-22/Modified risk at \$2.50 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.00 per share to reflect a modest tempo in the roll-out of commercial products as well as a less steep ramp for the BAT royalties. We have not given any value for the company's 25% ownership of Anandia or its exclusive US rights to four genes required for cannabinoid production in the cannabis plant. Risks to achieving our price target include delays in the FDA process, ability to find partners for X-22, challenges in attracting contract manufacturing and selling product overseas and possibility of requiring additional capital. The company is fully funded for almost two years.

Valuation:

We value X-22/Modified risk at \$2.50 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.00 per share. We have not included a value for the company's investment in Anandia.

Risks to achievement of target price:

Risks to achieving our price target include delays in the FDA process, ability to find partners for X-22, challenges in attracting contract manufacturing and selling product overseas and possibility of requiring additional capital.

Company description:

22nd Century owns or exclusively controls over 200 issued patents, 50 pending patent applications. The company's proprietary technology enables the control of nicotine levels in tobacco plants by controlling the genes responsible for nicotine production in tobacco plants.

22nd Century Group, Inc.
Actual v. Estimates

Q1 17			
	Actual	Estimates	
Revenue	\$ 2,232	\$ 1,552	43.8%
Cost Of Goods Sold	2,505	1,641	52.7%
Gross Profit	(274)	(89)	NM
R&D	551	550	0.2%
G&A	1,620	1,400	15.7%
Sales & marketing	296	350	-15.5%
Depreciation & Amort.	229	193	19.0%
Opex	2,696	2,493	8.2%
Operating Income	\$ (2,970)	\$ (2,581)	-15.1%
Interest Expense	8	(2)	
Other	346	0	
Warrant Charge	(5)	0	
Pretax Income	(2,621)	(2,583)	
Income Tax Expense	0	0	
Net before Minority Interest	(2,621)	(2,583)	
Minority Interest			
Net to Common	\$ (2,621)	\$ (2,583)	
Shares	90,700	90,698	
EPS	\$ (0.03)	\$ (0.03)	

22nd Century Group, Inc
Income Statement \$ in 000s

	2014	2015	2016	Q1 17	Q2 17 E	Q3 17 E	Q4 17 E	2017 E	2018 E
Revenue	\$ 529	\$ 8,522	\$ 12,280	\$ 2,232	\$ 2,582	\$ 5,087	\$ 6,642	\$ 16,543	\$ 21,500
Cost Of Goods Sold	498	9,103	12,710	2,505	2,600	4,644	6,021	15,770	19,350
Gross Profit	31	(581)	(430)	(274)	(18)	444	621	773	2,150
R&D	1,249	1,669	2,341	551	550	550	550	2,201	2,314
G&A	8,793	7,760	6,193	1,620	1,400	1,400	1,400	5,820	6,806
Pre-Mfg. Facility Costs	1,177	0	0					0	0
Sales & marketing	86	1,358	1,582	296	350	350	350	1,346	1,242
Depreciation & Amort.	463	676	842	229	193	193	193	807	770
Opex	11,768	11,463	10,958	2,696	2,493	2,493	2,493	10,174	11,132
Operating Income	\$ (11,737)	\$ (12,044)	\$ (11,388)	\$ (2,970)	\$ (2,511)	\$ (2,049)	\$ (1,872)	\$ (9,401)	\$ (8,982)
Interest Expense	(7)	(22)	(21)	8	(2)	(2)	(2)	2	(8)
Other	(30)	889	(202)	346	0	0	0	346	0
Warrant Charge	(3,821)	145	30	(5)	0	0	0	(5)	0
Pretax Income	(15,595)	(11,032)	(11,581)	(2,621)	(2,513)	(2,051)	(1,874)	(9,058)	(8,990)
Income Tax Expense	0	0	0	0	0	0	0	0	0
Net before Minority Interest	(15,595)	(11,032)	(11,581)	(2,621)	(2,513)	(2,051)	(1,874)	(9,058)	(8,990)
Minority Interest	0	0	0					0	0
Net to Common	\$ (15,595)	\$ (11,032)	\$ (11,581)	\$ (2,621)	\$ (2,513)	\$ (2,051)	\$ (1,874)	\$ (9,058)	\$ (8,990)
Shares	59,993	68,143	79,843	90,700	90,723	90,773	90,823	90,755	91,417
EPS	(\$0.26)	(\$0.16)	(\$0.15)	(\$0.03)	(\$0.03)	(\$0.02)	(\$0.02)	(\$0.10)	(\$0.10)

22nd Century Group, Inc
Balance Sheet and Cash Flow Statement \$ in 000s

	2014	2015	2016	Q1 17	Q2 17 E	Q3 17 E	Q4 17 E	2017 E	2018 E
Cash	6,403	3,760	13,468	10,729	8,085	6,327	4,707	4,707	2,476
Due from related party and officers	46	0	0	0	0	0	0	0	0
A/R	0	51	41	2	478	482	528	528	616
Inventory	2,065	2,706	3,093	3,035	3,136	4,814	5,945	5,945	4,973
Prepaid Consulting Fees	1,979	0	0	0	0	0	0	0	0
Prepaid Exp.	214	636	196	434	448	688	850	850	711
Total Current Assets	\$ 10,707	\$ 7,154	\$ 16,797	\$ 14,200	\$ 12,147	\$ 12,311	\$ 12,029	\$ 12,029	\$ 8,776
Patent and Trademark costs	7,078	7,364	7,390	7,439	7,378	7,316	7,255	7,255	7,010
PP&E	2,851	2,556	2,435	2,360	2,396	2,428	2,455	2,455	2,519
Equity Investment	1,318	1,223	1,020	1,366	1,366	1,366	1,366	1,366	1,366
Total Assets	\$ 21,954	\$ 18,296	\$ 27,642	\$ 25,365	\$ 23,287	\$ 23,422	\$ 23,106	\$ 23,106	\$ 19,672
Bank Loans and N/P	495	309	308	314	314	314	314	314	314
A/P	884	1,283	1,340	1,729	1,786	2,742	3,386	3,386	2,833
Accrued Expenses	1,294	1,570	1,601	1,376	1,422	2,183	2,696	2,696	2,256
Deferred Revenue	0	0	0	0	0	0	0	0	0
Total Current Liabilities	\$ 2,673	\$ 3,162	\$ 3,249	\$ 3,419	\$ 3,522	\$ 5,239	\$ 6,397	\$ 6,397	\$ 5,402
Long-Term Debt	605	308	0	0	0	0	0	0	0
Accrued Severance	412	200	0	0	(69)	0	0	0	0
Warrant Liability & Other	3,043	2,898	59	64	64	64	64	64	64
Shareholder's Equity	15,220	11,729	24,334	21,882	19,770	18,119	16,645	16,645	14,205
Total Liabilities And Equity	\$ 21,954	\$ 18,296	\$ 27,642	\$ 25,365	\$ 23,287	\$ 23,422	\$ 23,106	\$ 23,106	\$ 19,672
Net Income	(15,595)	(11,032)	(11,581)	(2,621)	(2,513)	(2,051)	(1,874)	(9,058)	(8,990)
Depreciation & Amort.	463	774	842	205	150	155	159	668	681
Stock Comp	2,293	1,326	881	169	350	350	350	1,219	1,400
Other	6,740	2,341	241	(318)	(69)	69	0	(318)	0
Working Capital	(483)	(731)	(270)	(129)	(488)	(205)	(181)	(1,003)	28
Operating Cash Flow	\$ (6,583)	\$ (7,322)	\$ (9,888)	\$ (2,695)	\$ (2,569)	\$ (1,683)	\$ (1,545)	\$ (8,493)	\$ (6,881)
Acquisition of Patents and trademarks	(727)	(413)	(357)	(30)	0	0	0	(30)	0
Capx	(212)	(37)	(197)	(14)	(125)	(125)	(125)	(389)	(500)
Other	(1,769)	0	0	0	0	0	0	0	0
Investing Activities	\$ (2,708)	\$ (451)	\$ (554)	\$ (44)	\$ (125)	\$ (125)	\$ (125)	\$ (419)	\$ (500)
Debt	(4)	(508)	(333)	0	0	0	0	0	0
Equity	9,859	5,592	20,483	0	50	50	50	150	5,150
Other	7	46	0	0	0	0	0	0	0
Financing Activities	\$ 9,863	\$ 5,130	\$ 20,149	\$ -	\$ 50	\$ 50	\$ 50	\$ 150	\$ 5,150
Change in Cash	\$ 572	(\$2,642)	\$ 9,708	(\$2,739)	(\$2,644)	(\$1,758)	(\$1,620)	(\$8,762)	(\$2,231)

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			Count	Percent
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22nd Century Group, Inc. (XXII) - \$1.40 - Buy

Price Target \$3.50

VALUATION:

We value X-22/Modified risk at \$2.50 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.00 per share. We have not included a value for the company's investment in Anandia.

RISKS TO ACHIEVEMENT OF TARGET PRICE:

Risks to achieving our price target include delays in the FDA process, ability to find partners for X-22, challenges in attracting contract manufacturing and selling product overseas and possibility of requiring additional capital.

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